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Brazil's Transfers

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Brazil's transfers

Federal tax revenues are shared with states and municipalities. Revenues come from two main taxes:

- **Income taxes**
- **Tax on Industrial products.**

State share:

- **21.5% of total shared revenues**
- **of that amount, 85% goes to states in poor regions**
- **remaining 15% to states in other regions**
- **among states in either category, 95% is distributed as a function of population and per capita income; 5% distributed in proportion to geographical area.**

Municipal share

- **22.5% of total shared revenues**
- **of that amount, 10% to state capital cities.**
- **distribution among capital cities is a function of population and per capita income.**
- **The remaining revenue (90% of the total) is distributed to remaining municipalities as a function of population and per capita income.**

Transfer formulas should have the following characteristics:

- They should be simple and easily understood
- There should be no reward for grantsmanship
- Calculation should not require exotic data
- "Data" should not be subject to debate.
- Transfers should not discourage local tax effort
- If transfers reflect some concept of "equalization", the concept used should have intuitive appeal.
- Equalization transfers should not be based only on the observation that some local governments receive less in transfers than other local governments.

Problems with basing equalization transfers on tax effort.

- Equalization grants should be unconditional
- If a local government chooses to raise its own taxes to provide its own citizens with a standard of service higher than national average it should not receive an equalization payment (a reward) for doing so.
- Rewarding tax effort is likely to reward already rich jurisdictions with well established tax bases.
- Strategic behavior is encouraged.
- Equalization transfers may induce poor districts to overly tax, thereby threatening economic development.

Index of fiscal capacity

In its simplest form, the index of fiscal capacity is:

$$\mathbf{I} = (\mathbf{Base}_n * \mathbf{Rate}_n) - (\mathbf{Base}_l * \mathbf{Rate}_n)$$

$$= \mathbf{Rate}_n(\mathbf{Base}_n - \mathbf{Base}_l)$$

where:
I = Index of fiscal capacity
Base = tax base for the tax or taxes in question
n = national
l = local government
Rate = rate of taxation expressed as a proportion of the base.

In words, the equation says that the index I, is the difference between average national per capita tax revenue from a given base and average local tax revenue that could come from the same local base if national average tax rates were applied.

I > 0 indicates below average fiscal capacity

In the Indonesian case we may want to include as fiscal capacity any revenue received by a local government from taxes on national wealth. If revenue from national wealth taxes are shared on a derivation basis not all local governments may receive revenue from this source. However, for those that do this could be a major source of revenue. Therefore we should expand the index to I', where:

$$\mathbf{I' = I - Wealth_i}$$

Where:
Wealth$_i$= per capita national wealth-related receipts, for each local government

I' > 0 indicates relatively low fiscal capacity

We may wish to expand the index again to add an index of fiscal need. Fiscal need is defined as the relative cost of providing devolved functions. A **fiscal gap** index is fiscal capacity minus the relative cost of required public services. Therefore the index becomes **I''** where:

$$\mathbf{I''} = \mathbf{I} - \mathbf{Wealth}_{l} - (\mathbf{Cost}_{n} - \mathbf{Cost}_{l})$$

Where:
Cost = per capita costs of devolved functions

Again, **I''** > 0 indicates relative fiscal need.